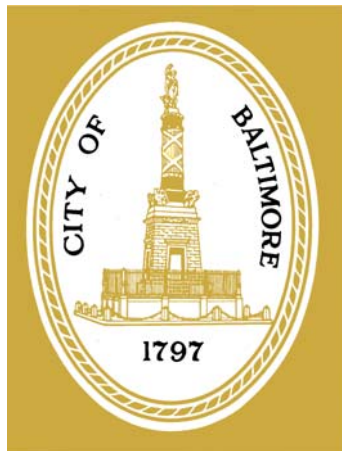

Review of
Water and Waste Water
Proposed Rate Increases
Effective April 2003



City of Baltimore
Department of Audits

CITY OF BALTIMORE

MARTIN O'MALLEY, Mayor



DEPARTMENT OF AUDITS

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March 13, 2003

Honorable Joan M. Pratt, Comptroller
And Other Members of the Board of Estimates
City of Baltimore

We reviewed the methodology and procedures used to determine the proposed 9% Water and 9% Waste Water rate increases submitted for the Board of Estimates' approval by the Department of Public Works (DPW) and Director of Finance. The effective date of the proposed rate increases is anticipated to be April 24, 2003. The purpose of our review was to determine whether the methodology and procedures used to determine the April 2003 rate increases were reasonable and whether the applicable computations were accurate.

As required by the December 1978 Charter Amendment, the City Council adopted Ordinance 941 which established, among other things, a mechanism for the determination of rates and charges for water and waste water services. Ordinance 941 requires that the City's Water and Waste Water Utility Funds (Utilities) establish rates or adjust rates to make the Utilities self-supporting. Ordinance 941 also requires that the rates be established at a level sufficient to recover any accumulated deficit from prior years. Additionally, the Utilities must comply with revenue bond covenants that cover the utility rates.

The City has entered into a Consent Decree with the U.S. Environmental Protection Agency and the Justice Department and the Maryland Department of the Environment to address past and periodic discharges and wet weather overflows from the City's Waste Water collection system. As part of the Consent Decree, the City must significantly increase and accelerate its existing Capital Improvement Program (CIP) for the Waste Water System. In order to cost-effectively meet the terms of the Consent Decree, fund other Water and Waste Water CIP projects and minimize projected customer rates, the City has developed a comprehensive multi-year plan of finance to modernize and strengthen bond covenants. Last spring, the City restructured its Water and Waste Water debt to help fund the CIP on an affordable basis.

In order to determine the need for the proposed rate increases, Utilities personnel prepared a comprehensive financial model that projects revenues, expenditures, cash balances and reserves for fiscal years 2003 through 2008. The projected revenue requirements and proposed rate increases are based upon expected CIP projects, sources of funds and new legal covenants. The proposed 9% Water and Waste Water rate increases will increase revenues for fiscal year 2004 by \$4.7 million and \$6.2 million for the Water and Waste Water Funds, respectively. The proposed rate increases provide more reserve funds than required to meet expected legal

covenants and required bond coverage through fiscal year 2004. However, according to Utilities personnel, the additional reserve funds make the Utilities' revenue bonds more attractive to investors, resulting in favorable interest rates when bonds are sold. Also, the additional reserve funds will be utilized in subsequent years to ensure moderate and predictable rate increases rather than large, one-time rate increases. Based upon the comprehensive financial model, annual rate increases for the Utilities for fiscal years 2005 through 2008 are also expected to be 9%.

Based on our review of the methodology and procedures used to calculate the proposed rate increases and our review of DPW's projections of revenues, expenditures, cash balances and reserves, the proposed rate increases are reasonable. However, since the comprehensive financial model indicates that annual rate increases of 9% are also expected for fiscal years 2005 through 2008, we encourage DPW to look for other cost-saving measures that could reduce future rate increases.

Respectfully submitted,

Yovonda D. Brooks, CPA
City Auditor